

TAX TREATIES-AN OVERVIEW

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Workshop on Basics of International Taxation

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SYNOPSIS

- * International Taxation- An Introduction**
- * Tax Treaties-An Introduction.**
- * Tax Treaty Structure**
- * Discussion of prominent Articles of a Tax Treaty**
- * Some important concepts**

INTERNATIONAL TAXATION

AN INTRODUCTION

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GLOBALIZATION

What is Globalization ?

Globalization is the phenomenon of

- × Sourcing capital from where it is cheapest,
- × Sourcing people from where it is best available,
- × Producing where it is most cost effective and
- × Selling where the markets are.

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INTERNATIONAL TAXATION- MEANING

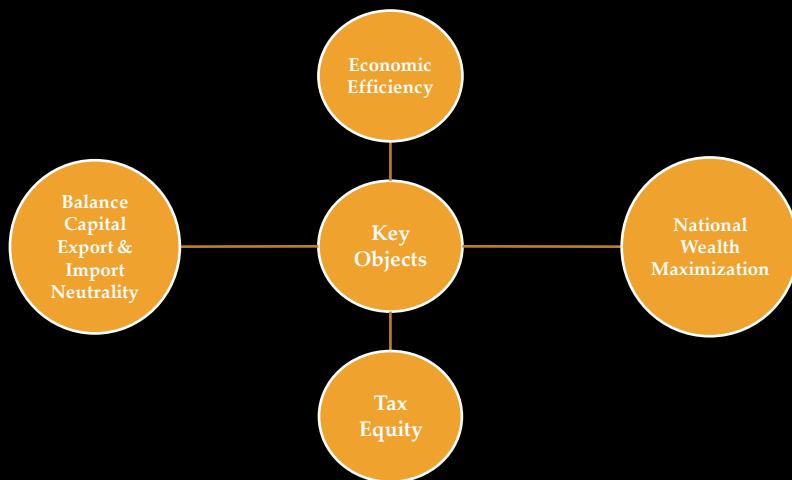
It is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions.



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INTERNATIONAL TAXATION-OBJECTIVES



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TAX TREATIES

AN INTRODUCTION

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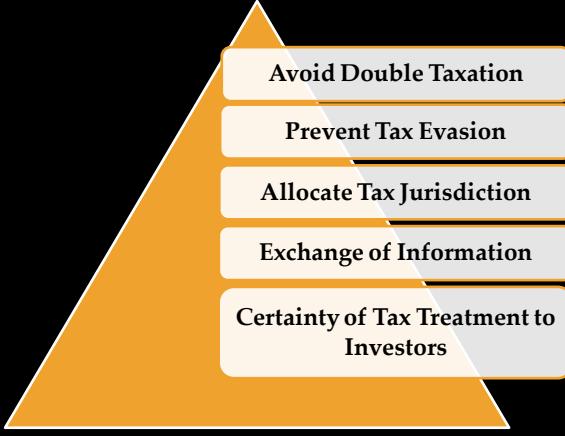
TAX TREATY

- **Meaning**-A tax treaty is a formally concluded and ratified agreement between two independent nations (bilateral treaty) or more than two nations (multilateral treaty) on matters concerning taxation

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OBJECTIVES



- Avoid Double Taxation
- Prevent Tax Evasion
- Allocate Tax Jurisdiction
- Exchange of Information
- Certainty of Tax Treatment to Investors

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TAX TREATIES- EVOLUTIONARY MILESTONES

1899	•The first DTAA entered in to between Prussia & Austria
1928	•The first model draft DTAA was published with the concept of PE being introduced for the first time
1943	•The Mexico Model was released
1946	•The London Model convention was released
1956	•The OEEC took upon the task of improving the model DTA to suit the needs of its member countries
1961	•OEEC was superseded by OECD
1963	•The first draft of OECD model was published
1977	•The final version of the OECD Model was published & has been last revised in 2008
1979	•Developing countries take recourse to UN model as OECD model is biased towards Developed nations (Last Update in 2001)
1981	•US model is introduced. Last revised in 2006

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MODEL CONVENTIONS

Model conventions-

- ✖ provide the broad framework for treaty formulation
- ✖ serve as useful interpretation material

The popular model conventions are:

- a) UN Model
- b) OECD Model
- c) US Model

TYPES OF TAX TREATIES

- ✖ Limited Treaties-which cover -
 - a) income from operation of aircrafts and ships,
 - b) estates,
 - c) inheritance and
 - d) gifts.
- ✖ Comprehensive Treaties-which are wider in scope addressing all sources of income

TREATY POSITION IN INDIA

- **Section 90(1) of the Indian Income Tax Act, 1961** authorizes the Central Government to conclude tax treaties
- **India presently has treaties with 91 countries**
- **Section 90 (2) of Income Tax Act Vs. Section 258(8) of the Direct Tax Code**
- **Section 91 - provides unilateral relief**

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TAX TREATY STRUCTURE

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ARTICLES- CLASSIFICATION

Application Articles	Definition Provisions	Anti-Avoidance Provisions	Elimination of Double Taxation	Miscellaneous Provisions
<ul style="list-style-type: none"> Article 1-Applicability Article 2- Taxes Covered Article 30-Entry into Force Article 31-Termination 	<ul style="list-style-type: none"> Article 3-General Definitions Article 4-Residence Article 5-Permanent Establishment 	<ul style="list-style-type: none"> Article 9-Associated Enterprises Article 26-Exchange of Information Article 27-Assistance for collection of tax 	<ul style="list-style-type: none"> Article 23-Elimination of Double Tax 	<ul style="list-style-type: none"> Article 24-Non-Discrimination Article 28-Diplomats Article 25-Mutual Agreement Article 29-Territorial extension

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DISTRIBUTIVE ARTICLES

- ✗ Article 6-Immovable Property
- ✗ Article 7-Business Profits
- ✗ Article 8-Shipping, etc.
- ✗ Article 10-Dividends
- ✗ Article 11-Interest
- ✗ Article 12-Royalties & Fees for Technical Services
- ✗ Article 13-Capital Gains
- ✗ Article 14-Independent Personal Services
- ✗ Article 15-Dependent Personal Services
- ✗ Article 16-Directors
- ✗ Article 17-Artistes & Sports persons
- ✗ Article 18-Pensions
- ✗ Article 19-Government Services
- ✗ Article 20-Students
- ✗ Article 21-Other Income
- ✗ Article 22-Capital

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PROMINENT ARTICLES -A DISCUSSION

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SCOPE

Article 1- Applicability -Applies to a person who is a resident of one or both the countries.

Article 2- Taxes covered- Taxes on income and capital

✗ Indian taxes covered are income tax, surcharge and cess

Article 30-Entry into force

This article tells when and how a DTA becomes operative

Article 31-Termination

This article tells when and how a DTA can be terminated

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DEFINITIONS

✖ Article 3-General Definitions

1. Person
2. Company
3. Contracting State
4. Enterprise of a Contracting State
4. Competent Authority
6. National

Undefined Terms-meaning to be as defined under the domestic tax laws applicable to the taxes covered in the treaty

DEFINITIONS

Article 4 - Residence

A person is a resident of a country if he is liable to tax in the country by virtue of:

- Domicile
- Residence
- Place of Incorporation
- Place of management
- Any other criterion of a similar nature

✖ Tie-Breaker Rules- In the case of a dual resident, the tie-breaker rules shall apply to determine the residential status

- a) In the case of an individual his personal and economic ties determine his residential status
- b) In the case of others it is the place of effective management

DEFINITIONS

Article 5 - Permanent Establishment (PE)

- ✖ Means a fixed place from where the business of the enterprise is carried on
- ✖ PE includes place of management, branch, office, factory, workshop, mine, quarry, an oil or gas well, a construction site for long duration, a services location for long duration and a dependent agency with power to conclude contracts

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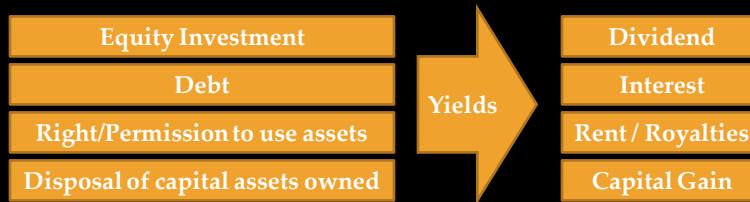
DISTRIBUTIVE PROVISIONS

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ACTIVE & PASSIVE INCOME

- Passive Income-refers to income derived from investment in tangible / intangible assets.



- Active Income is the income derived from carrying on active cross border business operations or by personal effort and exertion as in case of employment.

PASSIVE INCOMES-DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
6	Income from Immovable Property	Has the first right to tax		
10	Dividend Income	Has the right to tax provided rate does not exceed the agreed rate of tax as per DTAA	Reserves the right to tax	Dividend is not taxable in India. DDT is levied upon the company declaring dividends
11	Interest Income			
12	Royalties and Fees for Technical Services			
13	Capital Gains	Has the first right to tax a		Tax can be determined as per the domestic law
18	Pensions	Cannot tax pension	Can tax Pension	

ACTIVE INCOMES-DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
7	Business Profits	Yes, if PE exists in the source state	Reserves the right to tax	Income attributable to PE alone can be taxed in source state
8	Shipping & Air Transport	Cannot tax this income		
14	Independent Personal Services	Yes, if the person has a fixed base or his stay extends beyond 90 days		Income attributable to Fixed Base alone can be taxed in source state
15	Dependent Personal Services (Employment)	Yes, if employment is exercised in the source state. Cannot tax if stay is less than 183 days		If salary is paid on behalf of foreign employer and is not borne by PE, then source state cannot tax the salary

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ACTIVE INCOMES-DISTRIBUTION OF TAXING RIGHTS

Article Ref.	Nature of Income	Taxing Right of Source State	Taxing Right of State of Residence	Remarks
16	Directors' Fees	Yes, the source state can tax the same	Reserves the right to tax	
17	Artiste & Athletes	Yes, the source state can tax the same		DTA may specify the extent to which the income may be exempt
19	Govt. Service Remuneration	No, unless the person rendering service happens to be a resident of and national of the source state		
20	Students & Apprentices	No taxing rights		
21	Other Income	Yes, the source state can tax the same		

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ANTI-AVOIDANCE PROVISIONS

Article Ref.	Title	Comments
9	Associated Enterprises	Adoption of <u>Arms Length Price</u> in transactions between Associated Enterprises
26	Exchange of Information	
27	Assistance in collection of taxes	Both the contracting states shall assist each other in collection of revenue claims

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ELIMINATION OF DOUBLE TAXATION

Juridical Double Taxation and Economic Double Taxation

Article 23 –Alternate methods are as below:

- ✖ The Exemption Method
 - Full Exemption
 - Exemption with progression
- ✖ Foreign Tax Credit Method
 - Full Credit
 - Ordinary Credit
- ✖ Deduction Method

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MISCELLANEOUS PROVISIONS

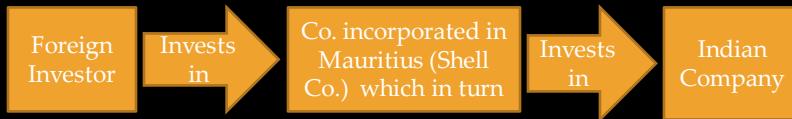
Article Ref.	Title
24	Non-Discrimination
25	Mutual Agreement Procedure
28	Diplomats
29	Territorial Extension

INTERPRETATION OF TREATY

- ✖ Tax Treaty Vs. Domestic Law
- ✖ The Vienna Convention on Law of Treaties, 1969 (VCLT) has codified international law. The rules contained in it can be applied to interpret treaties.
- ✖ Section 31(1) to 31(4) of the VCLT, 1969 lays down the foundation for interpretation as per customary international laws
- ✖ Section 31(1) states that a DTA shall be interpreted in GOOD FAITH in accordance with the ORDINARY MEANING to be given to the terms of the treaty in their CONTEXT and in the light of its object.
- ✖ Treaties are based either on UN or OECD model. Hence commentaries in these models may assist interpretation

SOME IMPORTANT CONCEPTS

✖ Treaty Shopping



✖ Most Favored Nation (MFN) Clause

✖ Protocols

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APPLYING TAX TREATIES

- Step 1 What is the nature of the income ?
- Step 2 Does the treaty apply?
- Step 3 Determine which Article applies?
- Step 4 How are taxation rights assigned?
- Step 5 How is the income calculated?

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REFERENCE MATERIAL

International Tax Policy and Double Tax Treaties by Kevin Holmes

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